federal register

FRIDAY, NOVEMBER 7, 1975

PART III:

INTERSTATE COMMERCE COMMISSION

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CONTINUATION SUBSIDY DECISIONS

Criteria for Rail Service

INTERSTATE COMMERCE COMMISSION

[Ex Parte No. 293 (Sub. No. 6)]

CONTINUATION SUBSIDY DECISIONS

Criteria for Rail Service

On June 9, 1975 (40 FR 24686), the Director of the Rail Services Planning Office ("Office") of the Interstate Commerce Commission issued a notice of Intent To Establish Criteria, pursuant to Section 205(d)(4) of the Regional Rail Reorganization Act of 1973 (the "Act") which directs the Office to:

* * * Assist States and local and regional transportation agencies in making determinations whether to provide rail service continuation subsidies to maintain in operation particular rail properties by establishing criteria for determining whether particular rail properties are suitable for rail service continuation subsidies. * * *

This particular duty of the Office is related to other provisions of the Act, which provide for the preservation of certain rail services in the Northeast and Midwest Regions if States, local or regional transportation authorities, users of rail services or other responsible persons offer to make "rail service continuation subsidy" payments (Section 304); and which provide for a two-year Federally supported assistance program of $90 million for each of two fiscal years (Sections 402 and 403). The Federal share of rail service subsidy costs under Section 402 will be 70 percent, with the remaining 30 percent share to be provided by each State, subject to entitlement as spelled out in Section 402(b)(1) and (2). Eligibility, for a subsidy is covered under Section 402(c). Under Section 403 of the Act. Federal loans or loan guarantees for the acquisition or modernization of rail properties will not exceed 70 percent of the purchase price or the cost of rehabilitation.

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In addition to the requirement that it publish criteria to assist in the making of rail service continuation subsidy decisions, the Office was directed under Section 205(d)(3) of the Act, to publish standards for determining the level of rail service continuation subsidy payments. Such standards were the subject of a proceeding, Ex Parte No. 293, (Sub. No. 2), Standards for Determining Rail Service Continuation Subsidies ("Subsidy Standards"), and were published on July 1, 1974, at 39 FR 24294, with amendments on January 8, 1975, at 40 FR 1624 and with additional amendments on March 28, 1975, at 40 FR 14186. In order to avoid possible confusion, it should be noted that this proceeding pertains to subsidy criteria, required to be issued by the Office under Section 205(d)(4) of the Act, and not to subsidy standards, issued previously by the Office pursuant to Section 205(d)(3).

The Act specifies under Section 205 (d)(4) that the subsidy criteria include the following considerations:

* * * Rail properties are suitable if the cost of the required subsidy for such properties per year to the taxpayers is less than the cost of termination of rail service over such properties measured by increased fuel consumption and operational costs for alternative modes of transportation; the cost to the gross national product in terms of reduced output of goods and services; the cost of relocating or assisting through unemployment, retraining and welfare benefits to individuals and firms adversely affected thereby; and the cost to the environment measured by damage caused by increased pollution. * * *

It is clear from the Act that the subsidy criteria are to be advisory in nature, and in no respect should they be construed as compulsory guidelines which must be followed by any party in connection with any provisions of the Act. However, Federal Railroad Administration regulations promulgated under § 255.9-(b)(1)(ii), Requirements for State Rail Plan for Rail Transportation and Local Rail Services, Continuation of Local Rail Services, procedures and Requirements Regarding Applications for and Disbursement of Rail Service Continuation Assistance, 49 CFR Part 255, FRA Economic Docket No. 3, Notice No. 2, issued with amendments on January 22, 1975 ("FRA Regulations") require that State Rail Plans submitted to the Federal Railroad Administrator must indicate consideration by the States of the Office's advisory subsidy criteria.

It is also clear that there is no legal requirement that the criteria be adopted pursuant to formal rulemaking procedures. However, the Office believed that public comment, suggestions, and criticism would prove valuable in developing the criteria. Therefore, the Office provided for, and invited, public comments to be filed with the Office on or before July 24, 1975. Although there was a noticeable lack of participation, the comments received provided a number of valuable suggestions which have been incorporated in these final rail service continuation subsidy criteria.

A. Background and Overview

The Act provides for a general reorganization and restructuring of the properties and services of the bankrupt railroads operating in the Northeast and Midwest which were found by their respective reorganization courts not capable of being reorganized under the normal bankruptcy laws. When the statutory planning process is completed and the Final System Plan ("Plan") for restructuring these railroads is effective, services over lines designated as not included in the Plan may be discontinued unless a rail service continuation subsidy is offered or some other appropriate action is taken.

On July 26, 1975, the United States Railway Assocation (the "Association"), the principal planning agency in the rail reorganization process, issued the Plan for restructuring the railroads. In the Plan, the Association identified some 5,760 miles of rail trackage that it recommends not be included in the new system (Consolidated Rail Corporation of "ConRail").

Prior to this time, in accordance with the FRA Regulations cited above, States were required to submit Phase I of their State Rail Plans to the Federal Railroad Administrator for approval by May 15, 1975. Phase II of the State Rail Plan is to be submitted for review within 30 days after the date of approval of the Plan by the Congress.

In Phase I, a State had to explain in detail how it intends to conduct its assistance program, including identification of the data to be acquired on the rail system in the State; the methodology to be used in determining which essential rail services should be continued; the criteria to be employed in ranking these services according to their service priority; and an explanation of the goals to be used in the development of the State Rail Plan. Under Phase II, a State must identify the specific services which should be continued as determined by the application of the Phase I methodology, criteria and goals in response to and consistent with the Plan; the order of funding priority of those services; and the amount and form of the assistance required.

Under the present statutory timetable, the plan could become effective—unless rejected by the Congress—as early as November 9, 1975. Beginning 30 days thereafter, or as early as December 8, 1975, the trustees of railroads in reorganization may give notice of their intention to terminate service on the lines not designated to be included in the Plan. Service discontinuance may become effective on a certain date which is not less than 60 days after date of each such notice. Thus, service on affected branch lines may actually be discontinued as early as February 7, 1976 unless a rail service continuation subsidy is offered.

B. Propose and Conceptual Approach

The purpose of the proposed criteria is to assist a potential subsidizer to decide whether a rail service continuation subsidy should be offered, or whether the rail service should be allowed to be terminated as requested in the notice of intention to terminate service.

While the Act permits potential subsidizers to be a rail user (shipper/reciver); a State Government (or agency thereof); a local or regional transportation authority (or agency); a community; or any responsible person, the Office is directed only to assist "States and local and regional transportation agencies". However, it is assumed that the criteria will be of interest to other concerned organizations and individuals who would not qualify technically as "transportation agencies", but who are intersted in determining whether to retain rail service and the framework in which such decisions should be made. Furthermore, the Office does not believe that it is within its mandate to provide specific criteria to guide individual business firms in determining whether to subsidize rail service for their own benefit, regardless of any benefits that might accrue to the

States, regions or communities in which the firms are located. In all probability, such firms will have available their own cost, revenue and other business information upon which to base such a decision.

The Office's conceptual approach in designing the criteria is to establish the planning framework in which rail service continuation subsidy decisions should be made; to identify relevant factors to be considered in the decision-making process; to present an analytical approach to the subsidy decision; and to identify alternative means of retaining rail service in addition to the subsidy program as provided in the Act.

The criteria are designed to serve as guidelines only. No claim is made that they are all-inclusive and comprehensive. However, their use by a potential subsidizer should provide a reasonable assurance that important issues and factors are not overlooked in the rail subsidy decision-making process.

The relevant factors which should be considered are numerous and complex. Some factors will be convertible to monetary terms, although ascertaining their specific values may be difficult. Other factors will be such that it may be impractical, if not impossible, to represent them in monetary terms. However, a measure of their value, even though it is subjective, may be an important determinant in the rail subsidy determination process. It is also important to recognize that the values assigned to particular factors can vary considerably depending on the perspective of the subsidy provider. These variations depend upon whether the factors are being evaluated at the local, regional, State or Federal level. Finally, it should be noted that in offering these criteria, the Office recognizes that each and every factor cannot be considered in every potential rail subsidy decision situation. Consequently, a potential subsidizer should be guided in the application of the criteria by conditions peculiar to the affected area and to the particular rail properties and services to question.

The Office recognizes that the identification of general subsidy criteria will not be helpful unless they can be applied to the individual situation of potential discontinuance of service. Moreover, those who would be affected by the discontinuance of rail service will have a short time frame in which to decide whether to offer a rail service continuation subsidy, take some other action to retain service, switch to alternative forms of transportation, or accept whatever remaining consequences exist. In short, this means making the decision whether the particular rail service is worth keeping from a public policy and planning perspective. In this regard, decision-makers have a total responsibility to insure that public funds are used to fulfill rail service and other transportation needs so as to minimize the cost to the public.

II. The Subsidy Decision Within a Transportation Planning Framework

Virtually all public subsidy decisions involve the choice of whether or not to use public funds to support the provision of a good or service which the private sector is unable to provide profitably. Since public funds must be viewed as scarce, like all resources, subsidy decisions must be carefully weighed so as to accomplish a rational use of public resources and to minimize the cost to the taxpayer. Achieving this goal depends critically on the perspective of decision-makers and the structure of the decision making process itself. A view that subsidies have little impact outside the immediate area of concern is a very myopic understanding of the consequence. Rather, the decision-maker must be keenly aware that subsidy decisions in one sector of the economy may have profound effects in other sectors, particularly those which are closely related. Consequently, a deecision to subsidize should be made only when it is determined that such a decision makes the best use of public funds.

Section 205(d)(4) of the Act requires that consideration be given to assessing comparative costs of alternative modes of transportation, along with other factors, in determining whether rail properties are suitable for rail service continuation subsidies. The specific language of this section makes it clear that the decision to subsidize is appropriate, if it is less costly to the public when compared to the alternative economic, social and environmental costs including transportation costs of not subsidizing. If this is not the case, a decision to subsidize is inappropriate, for it is less costly to provide some alternative transport service.

Section 255.9(a) of the FRA Regulations states:

> (a) State planning process. Consistent with the purposes of the Act, the State Rail Plan required under § 255.5(a) shall be based upon a comprehensive and coordinated planning process for the provision of rail transportation services in the State, which are essential to meet the economic, environmental and energy needs of the citizens of that State, and to provide for the development of a coordinated and balanced transportation system within the State or the affected portion thereof.

The language of the regulations essentially requires that state rail planning decisions be made within the context of an overall transportation framework. Obviously, decisions with regard to rail continuation subsidies are an integral part of state rail planning.

Both the language of the Act and the FRA Regulations make it apparent that rail continuation subsidy decisions involving the use of public funds should be made within a framework designed to achieve a balance in transportation planning and, concomitantly, a subsidy decision consistent with minimizing the cost to the taxpayer. Accordingly, the purpose of this discussion is to place the subsidy decision within the proper context of overall transportation planning.

A. Transportation Planning Perspective

With the passage of the Act, public officials and elected representatives have become directly involved in the making of decisions which affect the allocation of resources—capital, labor, and materials—both to and within the railroad industry. Historically, these decisions although constrained by public regulation, were a private and decentralized responsibility of individual railroads based on their respective perceptions of market opportunities, in sharp contrast to most other modes of transportation. The trend toward greater involvement in what have been traditionally private investment decisions apparently reflects the belief that rail services objectives are no longer capable of being met completely by the private sector.

Transportation is a vital economic function. With the possible exception perhaps of luxury passenger service, where "getting there is half the fun", transportation is not an end, but a means by which goods and services available in the economy are distributed. Essentially, transportation services to link markets by which goods and services available in this regard, the cost of moving freight in the form of raw materials, intermediate goods, or final products adds to commodity prices just as any input cost. The cost of moving passengers can be viewed identically, although consumers often bear the cost directly. In formulating transportation policy, it is important that transportation be viewed as a cost of production. In this light, rail service should not be preserved for its own sake, but for its value as a means of minimizing the cost of producing goods and services in the economy.

In most private market situations, market forces are activated by decision makers working for the most part, on a decentralized basis to make resource allocation choices in the economy. Through the interaction of these decentralized decisions, resources are allocated within the economy so as to minimize the costs of production. This allocation or market distribution of resources is the natural functioning of the economic system. When markets function in this manner, the result is an efficient combining of resources in the productive process with favorable prices to the consumer. In such cases, public planning is of limited value and may actually be a hinderance to the normal functioning of the market.

There are times when private markets do not operate freely and effectively so that an exclusive reliance on the private sector does not serve to allocate resources efficiently. The most obvious need for public intervention occurs when there is an effective absence of competition in a particular industry. For example, where a firm does not have a choice of service for transporting its products, it is a captive customer of the transport company

which serves the area. Historically, this was a major reason for regulating the transportation industry (although regulation was also espoused because there was in other instances too much competition). In the former situation, carriers are able to impose prices on the market rather than having to meet prices established by competitive mechanisms. Such manipulation of market power tends to reduce production and increase prices to consumers. In these instances, the challenge to the public transportation planner is to determine whether it is possible to maintain or restore competitive forces or to supplant the market mechanism through subsidy, acquisition or some other means.

There are times when the private market fails to capture the costs associated with certain resources used and therefore, fails to distribute these costs directly ot those responsible for their creation. For example, homeowners, rather than shippers, may have to bear the cost of noise and air pollution from trucks or railroads operating in their neighborhoods. Concomitantly, shippers may have to pay higher freight bills because of highway congestion caused by commuters. These externalities can be incorporated by public bodies into the price mechanism through user taxes, tolls and subsidies.

There may also be certain "public goods" or necessities, such as maintaining access to fossil fuel sources or maintaining an enlarged transportation system for use in national emergencies, which can be provided only by public authorities, since private business may have no incentives to produce them. Such goods are deemed to be a public responsibility because it may be impossible (or undesirable) to restrict their use and difficult to collect payments from users.

In the three cases of what might be construed as failings of the private market cited above, transportation planning at the state and regional level can contribute to the development of well functioning transportation systems. The role of planning should include the coordination, promotion, and where necessary, the regulation of transportation activity. In addition, public planning activity should be aimed at producing or restoring the orderly functioning of private markets, as well as achieving public policy objectives that otherwise could not be met through private market mechanisms.

B. The Meaning of Balanced Transportation

Transportation planning, including the rail service continuation subsidy decision, should be responsive to achieving an appropriate balance among the functioning of alternative modes within the transportation system. By the term "balance", it is meant that public resources should be devoted to alternative transportation modes in a manner which maximizes the total benefits to the public.

All too often in the past, transportation planning has meant a proliferation of disjointed transportation programs whereby subsidies are often overly dedicated to one mode. The result has been an imbalance within and a fragmentation of the total transport sector. Effectively, transportation has been compartmentarized as if it consisted of discrete and disjointed parts with little recognition to competitive effects and intermodal interdependency.

Excessive investment (more than is required to produce optimal benefits) in one mode will put other modes at a competitive disadvantage, thereby leading to reduced or discontinued service and financial losses to the competing modes. For example, some observers believe that over-investment in highways has provided trucking with an unwarranted competitive advantage over railroads. The argument is based on the view that trucking has not paid its share of the investment required for the highway system and, therefore, has gained a competitive advantage over railroads which are relegated to paying the total costs of developing and maintaining their rights of way. With the ever increasing fuel prices, the more energy efficient rail transport may continue to narrow that competitive edge. Therefore, unless transportation planning is viewed comprehensively trucking may be placed at a competitive disadvantage in the future.

Fragmentation, over-investment in particular modes, cross-subsidization and other problems have resulted largely from a segmented planning process which often has compelled decision makers to consider transportation issues on a mode-by-mode basis. Such an approach is the antithesis of achieving a rational use of transportation resources and is in vivid contrast to comprehensive and balanced planning which considers all modes simultaneously.

The development of a balanced transportation system is directed toward individual communities or markets, and their particular need for transportation service. For most locations, balanced transportation means planning for trucking, rail and other transport services jointly. For these planning circumstances the geographic size of the location or the extent of the market is of prime importance. There is no point encouraging resource allocation, either through direct cash subsidies or indirect subsidies (which may be in the form of regulatory policy), among competing transportation modes for a community which does not need or cannot support them. For some small markets, balanced transportation may mean only one mode or two modes serving distinct functions. Situations of this type should be recognized and planning undertaken accordingly. Besides the size of the market, the efficiency of the transportation mode at various levels of use is important and must be evaluated. An extremely important consideration in this task is that the unit cost of transportation changes with the scale of operation and market size. Whereas one mode might provide the lowest-cost service in a small market, another mode or a combination of modes may prove to be the least expensive in providing service for the commodity in a larger market.

The essential starting point for balanced transportation planning is to recognize that the primary objective of a transportation system is to provide the most economically efficient movement of freight and passengers. This objective requires that the full costs of all modal alternatives be explored.

Full costs means the costs to society, not simply the costs to the transport company. These include not only the cost of building capital facilities, the cost of maintaining and operating transportation services, but also social costs such as those associated with pollution and congestion. The private market has no direct way of establishing value or assessing the persons responsible for such social costs. Only when the capital and operating costs of each mode are determined on the same basis can a realistic comparison be made among them.

It is the proper and legitimate function of planners to assess these transportation costs, in conjunction with policy considerations, and to present them so that elected representatives and public authorities can make rational and intelligent choices among alternatives. Transportation investment decisions involving public monies can then be made in terms of what the cost would be if one decision rather than another were made. This is the principal contribution which balanced transportation planning can provide to public decision-makers. Concomitantly, rail service continuation subsidy decisions made within such a planning framework will achieve a more rational use of public funds.

III. Structure of the Subsidy Decision Making Process

As discussed previously, the decision whether to subsidize rail service should be reached within a comprehensive planning framework and be part of the development of a balanced transportation system. The central issues which must be addressed are the transportation needs of the public in both the short and long-run, and the means by which these needs can be met with a minimum use of resources. The undertaking of the actual subsidy decision, within a comprehensive planning framework, necessitates a structured approach of analysis. The approach offered herein follows a structured format in outlining the sequence of planning events and decision requirements, yet allows for analytical flexibility as individual situations dictate.

The approach to the decision-making process can be represented by a flowchart depicting analysis and planning activities. Figure 1 schematically shows the sequence of activities partioned into three major phases:

(1) Initiating Procedure.

(2) Analysis: Data and Decision Mechanism.

(3) Decision Options.

In phase (1), preliminary steps are undertaken to establish whether rail service should be preserved. Phase (2) consists of the suggested analytical procedure to be followed when a more thorough assessment of whether to subsidize rail service is needed. Phase (3) involves a consideration of the array of potential options available to the subsidy provider to retain rail service, once that decision has been made.

A. Initiating Procedure

As indicated by the flowchart (Figure 1), the decision process is triggered by the notification from an operating railroad of the intention to discontinue certain rail service ("Notice") and the probable intention to abandon certain rail properties. Rail service cannot be discontinued, however, if a rail service continuation subsidy, as defined in Section 304(c)(2)(A) of the Act, is offered by a responsible party. As required by Section 205(d)(3) of the Act, the amount of the subsidy necessary to maintain rail service will be determined pursuant to the Subsidy Standards promulgated by the Office.

Upon receipt of the Notice, an effort should be made to understand precisely the nature of the rail service to be discontinued and the potential properties to be abandoned. This is to prevent rail service discontinuance from occurring simply because of confusion and/or misunderstandings. The Subsidy Standards require that the Notice contain specific operating and other detailed information. Moreover, § 1125.8(d) states:

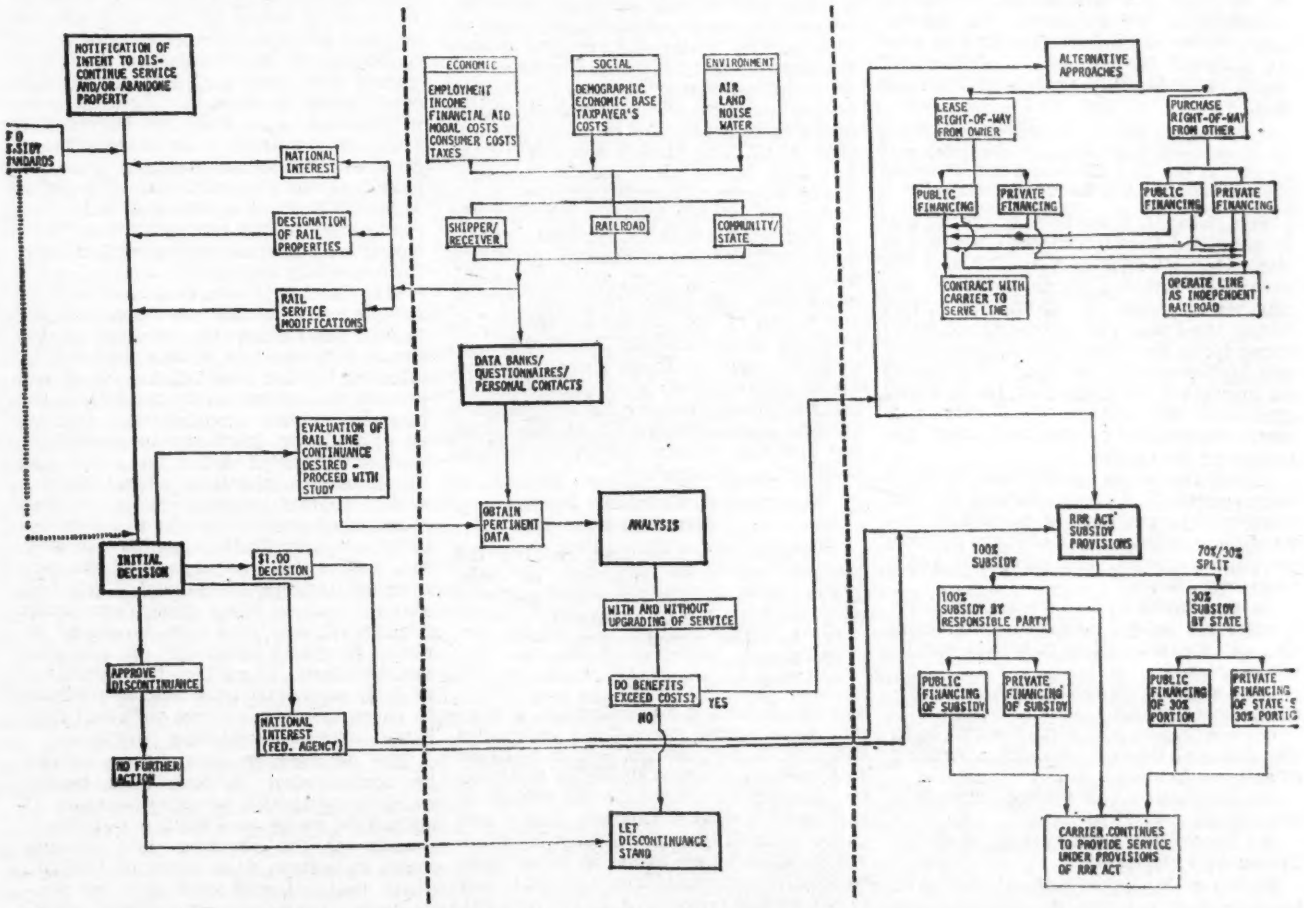
> • • • A notice of intent to discontinue (B) of the Act, is not considered to be completed or given until the railroad has taken the actions required by paragraphs (a) through (c) of this section. • • •

After verification that the Notice is complete, there are three avenues of inquiry that should be undertaken:

(1) The extent to which the rail service is in the national interest;

(2) A review of the designated rail properties to insure that the properties are those used and useful for the rail services in question; and

(3) The possibility of modifications to the service level, stipulated in the Notice.



An investigation should be made to determine whether a Federal agency considers the continuation of rail service necessary to the national interest and, consequently, a potential subsidy provider. Such a situation, for example, could arise where there is a military installation that requires rail service on a line designated for rail service discontinuance. Similarly, there may be situations where maintaining access to coal or other natural resources may be desirable from a national standpoint.

A second avenue of inquiry is to review the designation of used and useful properties in the Notice. The Act requires in Section 102(10) that the

> • • • rail properties (be) assets or rights owned, leased, or otherwise controlled by a railroad which are used or useful in rail transportation service. • • •

The Subsidy Standards require that the value of the properties over which rail service is to be discontinued be estimated by the railroad in its Notice. The basis of the valuation must be the net liquidation value of use and useful rail properties determined in accordance with § 1125.6(b) of the Subsidy Standards:

> • • • The value of the properties shall be their net liquidation value for their highest and best use, consistent with applicable zoning and land use regulations, determined by computing their current market value for other than rail transportation purposes, less all costs of dismantling and disposition of improvement necessary to make the remaining property available for its highest and best use. • • •

Obviously, either a change in designation or a change in the assigned value of rail properties can alter the determination of the required subsidy payment. The value of rail properties is used as the base to calculate the return to the trustees of the owning railroad. Therefore, it is important that a potential subsidy provider make certain that the rail properties are those necessary to provide the rail services required, i.e., those properties which are used and useful for the desired rail service.

Concurrently with the above inquiries, a detailed review of the service level identified in the Notice should be made so as to determine the adequacy or necessity of the stated service. The service level identified is used to determine portions of the on-branch avoidable costs of the rail line operations. There are possibilities for adjusting the subsidy amount by changing the service level as dictated by the needs of the rail users. The Subsidy Standards indicate that:

> * * * The number of trips per year will be based upon the frequency of service performed at the time the notice is filed unless the parties agree to a different level. * * *

For instance, if the level of service can be modified through mutual consent of the potential subsidy provider and the operating railroad so as to lower the number of trips or on-branch service hours, the lower will be on-branch operating costs, and consequently, the lower will be the required subsidy. This can be an important consideration, for in many situations the reliability of service is more important to shippers than the frequency of service.

After these three areas of inquiry have been pursued, a recalculation of the subsidy payment may be necessary, depending on whether any changes in service, rail property, and property value have been made.

At this point in the decision-making process an initial decision, comprising four alternative courses of action, can be contemplated:

(1) accepting and allowing the discontinuance to stand;

(2) continuing rail service which is in the national interest through a subsidy offer by a federal agency;

(3) continuing rail service through a subsidy offer of $1.00; or

(4) proceeding with further study of the subsidy decision.

Whether due to a lack of rail user concern, the fact that the rail line has been out of service with no interest to have it revitalized or for other reasons, there may be no opposition to discontinuance. When this is the case, the Notice may be acceptable and there is no need for further action. The intention of the railroad to discontinue service should be allowed to proceed in accordance with the provisions of Section 304 of the Act.

If the continuance of rail service is determined to be in the national interest, the service should be preserved by a subsidy offer from a federal agency, which would assume the role of a 100% subsidy provider pursuant to Section 304(c)(2) of the Act.

There is a potential situation where a subsidy offer of $1.00 is all that is necessary to preserve rail service. As indicated in the Subsidy Standards, some of the costing methodology and components used by the Office are different from those used by the Association:

> * * * Since the U.S. Railway Association is not required to utilize these standards as criteria for inclusion of branch lines in the Final System Plan, there is a distinct possibility that a branch could be excluded from the plan yet be profitable under the standards. * * *

When this situation arises, the subsidy offer necessary to continue rail service, as required by the Subsidy Standards, is $1.00.

The $1.00 subsidy situation undoubtedly offers an opportunity to maintain rail service while determining future transportation needs and the prospects for a viable transport system. It should be understood that the ultimate obligation of the subsidy provider could be for more than $1.00. The $1.00 amount is a bona fide offer of an initial subsidy payment in accordance with determinations made under the interim formula provisions of the Subsidy Standards. However, subsequent calculations of subsidy payments are determined by using actual operating experience (costs and revenues) within the period of the subsidy agreement, as required by the Subsidy Standards.

When none of these prior situations apply, further study is required to determine whether a rail service continuation subsidy should be offered. At this point, the planning process enters the second partition in Figure 1.

B. Analysis: Data and Decision Mechanism

The analysis phase, first, requires the identification and collection of data. There are essentially three categories of data considered to be pertinent:

(1) Rail Shippers/Receivers.

(2) Railroad.

(3) Community/State.

The identification and collection of specific data within these three categories will provide the relevant factors, as listed in Appendix A, which should be analyzed by planners to determine the effects of rail service discontinuance. Many rail users, communities and States have already undertaken tasks to investigate various factors considered to be pertinent to rail service operations. In general, the Rail Shipper/Receiver data identify the existing and potential commodity shipments by various modes, the economic considerations with regard to alternatives to rail service (costs of converting facilities, losses in retirement of plant and equipment, costs of equipment for alternative modes, etc.), the changes in employment, than the problems with regard to rail service requirements and to restrictions on movements of products by alternative modes. Rail Shipper/Receiver data should be gathered for each industry and/or business in the area which is directly or indirectly affected by the rail service. However, the predominate industries and/or businesses of concern are those that ship and/or receive goods by rail over the rail line in question. Because of the importance of this information to the decision-making process, considerable effort should be undertaken to acquire as extensive and as complete a date set as possible.

The identification and collection of certain Railroad data provides information on the existing rail system, the nature of existing and future freight and passenger rail service capabilities and operating policies, the employment and expenditures of railroads, the costs of maintenance and rehabilitation of plant and equipment, and the costs of operations. A significant portion of the railroad data, in most cases, will be obtained from the railroad petitioning to abandon rail service. Much of this data may be supplied by railroad employees or representatives in the immediate area concerned with potential rail service discontinuance (study area). However, some information may have to be supplied from other sources, such as corporate or divisional headquarters and/or State departments of transportation. The Office suggests that the potential subsidizer (and/or planning representative) work closely with railroad personnel to develop the necessary information.

The third category, Community/State data, should be used to develop a detained description (or profile) of the community (and/or State) that will be affected by the discontinuance of rail service and represents the purview of the potential subsidy provider. This description should be developed to specifically address financial, labor, planning and development, physical characteristics, and demographic characteristics as they effect employment, growth and development, civic institutions, public funding, etc. within the study area. Information may be acquired from local, State and Federal sources. Many times community profiles of this type are developed by civic, financial, political or planning organizations. Therefore, the assistance of such organizations should be solicited to determine areas where sufficient data exists to avoid duplicating efforts.

The data briefly outlined above can be accumulated through data banks, questionnaires and personal contacts. It should be recognized that a significant portion of the required data already exists in various data banks of Federal, State, regional, and local agencies, particularly Community/State data. However, there undoubtedly will be a need to update and make modifications to data sets, aside from collecting necessary additional information. An important source of information, particularly with regard to the shippers/receivers and the railroad, is the questionnaire. In many localities and States, such questionnaires have already been utilized. The information requested should be sufficiently detailed to be directly useable in establishing baseline and development characteristics, and to minimize ambiguity in their interpretation. Very often questionnaires are the first-line sources

of information for direct use in analyses and for establishing data banks. Furthermore, data bank and questionnaire sources of information can be supplemented by personal contacts or interviews. This approach can be used to clarify and amplify information gathered through other sources.

Factors to be considered in the analysis and methods of data collection, as well as actual forms and questionnaires which may be helpful, are presented in detail in "Guide For Evaluating The Community Impact Of Rail Service Discontinuance", prepared for the Office of Public Counsel, Rail Service Planning Office ("Guide") and in "Analysis of Community Impacts Resulting from the Loss of Rail Service", prepared for the U.S. Railway Association ("Analysis"). In addition, Appendix B lists other sources of information which may be of assistance to the analyst.

Generally, the data collected should be sufficient to identify the existing and future transportation needs within the study area, the structure and operation of the transportation system in meeting these needs, and the economic, social and environmental factors which are affected by a change in the transportation system—specifically the impacts resulting from the discontinuance of rail service. The collection and assimilation of such a data base is necessary for subsidy decisions which are consistent with the concept of balanced transportation.

From data collection and assimilation, the decision process moves directly into the analysis phase. The analytical procedure recommended by the Office is benefit-cost analysis. The benefit-cost approach is one of the traditional project evaluation tools used by public planners, particularly when projects involve the use of public funds. Benefit-cost analysis is a procedure whereby the social benefits of a proposed project are compared with its social costs. Generally, when social benefits are equal to or in excess of social costs, the undertaking of a project is deemed to be in the public interest. In the instant case, the objective of the benefit-cost procedure is to determine whether the benefits which will accrue from rail service continuance out-weigh the costs of discontinuing the rail service.

No attempt is made to provide a detailed description of the method of benefit-cost analysis. The Office believes that the circumstances of each rail line are unique; that the particular sources of data are better known to individual State and local planners; and that the capabilities of the various potential subsidy providers to perform benefit-cost analyses vary so widely that to attempt to prescribe a standardized methodology would not be meaningful. Moreover, the publications referred to as Guide and Analysis set forth in considerable detail procedures and methodologies for conducting benefit-cost analyses, specifically addressing rail service discontinuance. For these reasons, the Office believes that it is only necessary to provide a conceptual discussion of benefit-cost analysis, pointing out some of its critical aspects when applied to the problem of rail service discontinuance.

The nature of the benefits and costs, or the universe from which the benefits and costs are determined is dependent on the geographic area (study area or "impact community") affected by rail service discontinuance. The concept of impact community is discussed in the documents previously designated as Guide and Analysis. Defining the "impact community" is a critical task in the analysis. The scope of the data required, the extent and magnitude of evaluations, and the entire nature of the decision process depends on the designation of what constitutes the area affected by rail service discontinuance from the perspective of the potential subsidy provider. If the State is the potential subsidy provider, then the benefits and costs of maintaining rail service should be evaluated as they relate to the entire State. Similarly, if a county is the potential subsidizer then the relevant impact community is the county.

As just described, the nature of the benefit-cost analysis is governed by the geographic area of concern to the potential subsidy provider. In this regard, planning bodies are confronted with an array of questions to be answered in the benefit-cost procedure. What are the relevant economic, social and environmental factors to be considered to insure that a decision to allocate resources to maintain rail service is made to the total benefit of the constituent public? What are the benefits of retaining rail service compared to the cost of the subsidy? What are the feasible alternatives to the subsidization program for continuing rail service?

The benefit-cost concept, by its very nature, requires that factors be quantified and expressed in dollars to as great an extent as possible. Methods of quantification are discussed and presented in Guide and Analysis. However, there are certainly those factors which are affected by rail service discontinuance that cannot be adequately expressed in dollars with any satisfactory degree of reliance. These factors should be explicitly considered in qualitative terms.

As was the case in the determination of benefits, costs are dependent of the identity of the potential subsidy provider. The Act provides that subsidization can be undertaken within a 100% or 70%/30% funding program. States are eligible for the 70%/30% program, whereas the 100% subsidy program is applicable to any other responsible party undertaking the role of a potential subsidy provider. Therefore, any responsible party other than a State, such as a shipper or local or county transportation agency, must consider the entire subsidy amount as a cost of continuing rail service. Whereas, the subsidy cost of continuing rail service is only 30% to a State or a responsible party who chooses to use the State as a conduit for gaining access to the 70%/30% subsidy program.

Irrespective of those instances where the State is requested to undertake subsidization on behalf of other parties, it should be recognized that the State is conducting its own analyses in order to rank rail lines for subsidization as required by the FRA Regulations. Essentially, the State is making benefit-cost evaluations using the State as the "impact community" to determine the order in which rail lines ought to be subsidized. The State must also make a decision on the total amount of subsidy funds that will be requested from FRA for lines designated as non-viable by the Association in its Plan.

The State should establish a systematic approach for ranking the order in which rail service should be subsidized. A suggested approach is to identify all rail lines where the benefits of retaining rail service exceed or are equal to the costs of subsidizing such service. Then, from the set of rail lines which are suitable for a rail service continuation subsidy, the State should select those rail lines whose aggregate subsidization maximizes total net benefits and whose aggregate subsidy amount is less than or equal to the total amount of funds which are available for subsidy purposes.

The completion of the benefit-cost analysis, whether at the State or local level, effectively determines the rail services which are suitable for rail service continuation subsidies. The Office recommends the benefit-cost approach as the analytical vehicle because its proper use involves due consideration of all factors which influence the functioning of a transportation system. The Office believes that only with the application of such an approach will subsidy decisions be made with a total transportation perspective.

C. Decision Options

With detreminations made as to the suitability of maintaining rail service, the final decision is whether to subsidize rail service under the provisions of the Act or to preserve rail service by an alternative course of action. Although it may appear that the subsidy program is the least costly and most effective way of preserving rail service, this will not always be true depending on the circumstances and the goals of the potential subsidy provider as indicated below:

(a) There is no assurance that the federal subsidy funds will be provided for rail service longer than for a two-year period. There are obvious significant risks to letting time pass without considering alternative courses of action;

(b) The conditions and requirements established in the subsidy provisions of the Act, or in other proposed Federal or State legislation, may be too demanding, may be unattainable, or may be of a character which would more appropriately warrant independent self-help alternative approaches to continuing desired rail service. Such self-help approaches may provide the rail service at a lower cost (possibly even paying a net dollar operating profit), of a superior quality, or perhaps in a more efficient manner;

(c) Some situations might call for accepting Federal/State subsidies in concert with independently devised branch line approaches. These solutions could

assure less costly, more efficient rail service operations, rather than depending solely on Federal/State subsidies;

(d) Even if Federal/State subsidies are provided, a State may find that the available federal funds are inadequate to subsidize all rail lines considered essential. In these cases, alternative self-help efforts may offer the most reasonable opportunity for continued, reinstituted, or future rail service; and

(e) In cases where a branch line meets the suitability criteria for Federal/State subsidization, subsequent operations, occurrences, etc., could result in a withdrawal of such assistance. It would be advantageous to anticipate such possibilities and consider alternative self-help approaches before the subsidy is actually withdrawn.

It should be recognized that time, effort and expenses utilized in challenging rail service discontinuance in certain circumstances might be more beneficially applied to developing local self-help efforts to preserve service. Such efforts may have both short and long-term advantages superior to the subsidy program provided for under the Act.

IV. Alternatives to Subsidization Under the Act

The purpose of this section is to present a list and corresponding discussion of alternative methods of preserving rail service other than through subsidization under the provisions of the Act. The nature of each alternative and procedures for its implementation are described. Advantages and disadvantages are considered. No claim is made that the list or discussion is exhaustive. The section is designed to provide a familiarity with various alternatives to subsidization under the Act. In the event that one or more of these alternatives is viewed as helpful in preserving rail service, the Office recommends that further research be conducted before attempts at implementation.

A. Capital and Maintenance Assistance Projects

One of the major reasons for discontinuing service on light density lines is the deteriorated condition of the infrastructure. The Plan has assigned significant cost figures to the rehabilitation of rail plant. For many lines, rehabilitation costs have been large enough to cause the line to be non-viable and, therefore, excluded from ConRail. If a community or user makes a one-time investment in rehabilitation of a line, the line may be more economical to operate and therefore acceptable for operation by ConRail or a solvent railroad. Alternatively, this investment might provide the incentive needed to attract a short-line operator. Such investments can be the impetus to continued or improved rail service.

A line may become viable from an operator's standpoint simply by shifting the responsibility for maintenance or construction of various rail facilities from the railroad to another entity. Some of the capital assistance projects which could be sponsored by communities and users are: (1) repairs and rehabilitation of ties, rail, structures, bridges, stations, and gate crossings; (2) purchase of equipment; and (3) facilities construction, such as a team track or an interchange. Such a community-sponsored project may not only serve to make the line viable for ConRail or a short line operator, but also may stimulate demand for service along the line.

Another way in which assistance can be provided by a community or user is to assume all or part of the maintenance responsibilities of the line. They could provide ties, ballast and other track materials necessary for regular maintenance. Communities and users might also pay the labor costs associated with maintenance activities. Assumption of maintenance responsibilities might result in making the line profitable in terms of the Association's viability criteria since some, if not all, of the maintenance costs would not be incurred by the operating railroad.

B. Direct Participation of Users

The users of the line can also make a direct contribution designed to enhance viability without substantial capital outlays. Essentially, the users might ask the question, "What can I as an individual do to improve the viability of the operation?"

The community and users can alter profitability of a light density line by adjusting operating revenues and expenses. The methods include carload surcharges or revenue supplements, increased or guaranteed levels of traffic, and guarantees of annual revenues. Another method that is not widely used presently is a direct payment from the user to the railroad for maintenance of a siding.

A revenue supplement arises through an agreement by which shippers pay a surcharge on each carload transported. In effect, the line's shippers accept a rate increase. Therefore, the railroad receives an especially high incremental revenue for extending service to the light density line. Revenue supplements do not immediately convert a light density line from an uneconomic operation to a highly attractive service, but the railroad at least perceives the prospect of long-term profitability through shipper interest.

One of the principal problems in establishing a revenue supplement arrangement is securing the agreement of a large railroad company. Many railroads are not staffed to respond to innovative requests. Therefore, the community and shippers must be prepared to spend substantial time in seeking out representative of the railroad who have the authority to enter into a revenue supplement contract.

Another revenue enhancement approach is an agreement where the shipper will increase traffic or at least guarantee a specified level of traffic over a given period. A guaranteed level of traffic will be attractive to a railroad since it provides a dependable level of operating revenues. The problem facing interested shippers is to find a railroad representative with the commensurate authority to respond to their offer.

Guaranteed revenues can work for sidings also. One of the commonplace problems of railroading is that an inordinately large amount of maintenance is conducted on sidings. However, a very small portion of revenues earned by railroads are derived from sidings. The problem is that the railroad does not receive sufficient compensation from the infrequent user. The railroad maintains a switch and siding, yet it only collects revenues on the basis of tendered traffic. Too often the railroad is required to maintain numerous switching facilities and sidings of which only a few are useful in obtaining traffic. An approach to this problem is to internalize these costs. In other words, to pay for the maintenance of a siding, a tariff could be published to collect compensation from each plant located on the facility.

A local government can promote the use of a siding maintenance tariff. If the local government needs to raise revenues to finance its share of a light density line program, then it could tax all rail sidings. Therefore, all direct and indirect users of the rail facilities will contribute to the project. Furthermore, tax exemptions and credits could be extended to those who use the facilities.

C. Rail Banking

There will be situations where a rail line is no longer needed for rail transportation purposes, at least for the present. When such a case arises, the decision must be made whether to preserve the line for future needs or to use the line for non-rail purposes. This is popularly called "rail banking".

Section 206(c)(1)(E) o fthe Act requires the Association to designate in the Plan those rail lines which will not be operated by ConRail or a government entity or a responsible person, and are "suitable for use for other purposes, including highways, other forms of transportation, conservation, energy transmission, education or health care facilities, or recreation". Furthermore, Section 304(b)(2) of the Act requires that in cases where rail property is suitable for other public purposes and is to be abandoned, then a 180 day option must be given for the acquisition, upon reasonable terms, of such property for public purposes. Therefore, the Plan designates those properties which are suitable for public purposes. Such property, if designated for abandonment, cannot be sold unless first offered for public purposes. In addition, there are some state statutes which provide State governments with the right of first refusal to purchase rail properties.

Before any option to purchase rail properties is exercised, the decision must be made as to their potential value for rail purposes. There are at least two situations where a rail line is not worth operating currently, but could be a candidate for rail banking. First, there are coal deposits which are not being mined

at the present time, but are rail dependent. These deposits may become increasingly valuable in the future as advancements in technology ultimately enable high sulfur coal to be utilized. In addition, fluctuating coal prices may reach a point where certain sources currently too costly to mine can be mined profitably. Finally, as the energy problem facing the nation increases, the need to use coal will inevitably rise. If rail transportation is not available, then these reserves may not be obtainable. Furthermore, preservation of rail lines in areas with growth potential may be justified. Such lines could be used to attract industry to promote future development.

D. TOFC/COFC Service

An alternative or supplement to rail service is the establishment of trailer-on-flatcar (TOFC) or container-on-flatcar (COFC) services. TOFC/COFC is a method of transportation in which the consignment is containerized at the point of origin of shipment. The container is transported (usually by truck drayage) to a railroad terminal where it is transferred to a flatcar and then moved by the railroad to the terminating railroad yard and then transferred directly to the consignee's siding or drayed (via another mode) to the consignee. The key characteristics of this service are that the consignment remains in the same container throughout the entire haul and that the complete movement (origin to destination) requires at least one mode in addition to rail. Containerized rail service requires a special terminal equipped to handle the interface between the rail mode and other modes. Varying degrees of sophisticated and specialized equipment may be utilized in such a terminal. The simplest terminal useable for containerized rail freight is a system for TOFC only utilizing circus unloading and a ramp.[1] More complex than the portable ramp technique are terminals which use heavy machines to remove the box (container or trailer) from the car.

TOFC/COFC is attractive to railroads because it often provides a desirable substitute for inefficient switching and operations over rail lines. Also equipment devoted to TOFC/COFC services is usually far superior to conventional rail equipment. The railroad is attracted by the opportunity to develop the types of service which most efficiently capitalizes upon the railroad's operating characteristics, i.e., the long-haul unimpeded high density movement. Therefore, the railroad is attracted by the opportunity to supplant short-haul with TOFC/COFC service to its customers.

Some shippers will benefit substantially from substitution of intermodal services for low quality rail service. However, this will not be true for all shippers because the rates which apply to intermodal services are often higher than the rates which apply to commodity-rated general freight service. Due to the higher capacity of railroad rolling stock, rail rates for bulk commodities are often lower than truck rates; therefore, shippers of bulk materials such as grain, gravel, fertilizer, and particularly liquids are often disadvantaged in changing to intermodal service. Furthermore, shippers may have to invest in a revised layout of their plant in order to accommodate shipments arriving at a truck loading dock instead of at a rail siding.

TOFC/COFC can serve to improve transportation service because it may provide increased flexibility in tendering consignments. Various "plans" for TOPC/COFC service can be implemented:

Plan (1) Ramp-to-ramp service for motor carrier-owned trailers.

Plan (2) Door-to-door service in rail-owner trailers; railroad provides pickup and delivery.

Plan (3) Ramp-to-ramp service in rail-owned trailers with customer pick-up and delivery.

Plan (4) Ramp-to-ramp service for customer-owned trailers.

Plan (5) Door-to-door service with short-haul motor carriers under joint rate/route tariffs.

Other Mail & express move in separate plans. Other variations of the above plans are used sparingly. Containers generally are treated as trailers insofar as plan of movement is concerned.

The principal concern in determining the feasibility of TOFC/COFC is that a railroad typically requires a minimum threshold level of TOFC/COFC service in order to earn an acceptable rate of return to justify an investment in the intermodal facilities. Therefore, the shippers must provide enough traffic to keep the terminal profitable. A problem which will be encountered in many instances is the inadequacy of existing-traffic levels to justify the investment.

It should be clear from the preceding discussion that the provision of TOFC/COFC service is an alternative which will cause rail service on some lines to be discontinued while increasing the volume of traffic on other lines. Essentially, particular rail services are supplanted by a combination of other rail service and truck service with an interconnection at a central terminal facility. Transportation services are preserved, but with an alteration in the mix of modes. Without additional new traffic, the volume of shipments on such lines is often not sufficiently high to warrant the investment in an intermodal terminal. Furthermore, most railroads prefer to serve high density TOFC/COFC terminals. Remotely located terminals at the junction of light density rail lines may not be well suited for an efficient operating pattern. The substitution of the higher quality and higher cost intermodal services may be detrimental to the typical light density line shipper. Certainly, this is true for shippers of bulk commodities.

E. Short Line Railroad

Probably the most complex alternative to subsidization is the establishment and operation of a short line railroad. A short line railroad is normally considered to be a railroad operating as a common carrier under the definition of the Interstate Commerce Act and regulated by the Interstate Commerce Commission (ICC). It is assumed that a short line will not meet the definition of a Class I railroad as prescribed by the ICC (revenues in excess of $5,000,000 annually).

There are essentially three types of short line railroads: full-service common carrier, switching carrier and a private railroad. The distinguishing features of each are related to rate-making activities.

Most short lines are "full service common carrier" transportation companies. A common carrier is a transportation company which is obligated to accept shipments properly tendered by any user. Full service means that it performs all the services of a Class I railroad. It publishes tariffs or it participates in the publishing of tariffs. A tariff is a document published by a common carrier or its agency prescribing conditions under which shipments will be accepted for transportation and the rates and charges to be assessed for the service(s). Tariffs are established in a three step process: (1) Negotiation and concurrence with shipper(s) and other railroad(s), (2) negotiation and concurrence with a rate bureau, and (3) filing and publishing of tariffs with the ICC. The third step is subject to an appeal to the ICC by nonconcurring railroads and shippers. Therefore, this type of short line principally derives its revenues through its division of the through-rates paid by the shippers. Except where noted below, all regulatory and other railroad practices which normally apply to Class I railroads also apply to those short lines which are full service common carriers.

A short line which hauls cars on its lines and obtains revenue by collecting a charge, instead of a rate, for each car moved is a "switching carrier." A switching carrier essentially operates to switch traffic off of a main line. It is not responsible for charging demurrage, billing, preparing waybills, filing reports with weighing inspection bureaus, or putting cars in service. The main line railroad, for which the short line switches cars, administers these activities. It files and publishes "charges" with the ICC. A switching carrier does not participate in rate-making activities of rate bureaus and receives no division from through-rates. The switching carrier delivers cars, and bills the main line railroad for each car delivered at the established charge.

A short line which is owned and operated by a company for its individual transportation needs is a "private railroad". Situations will arise when the appropriate structure for the operating company will not be as a common carrier. In these cases, a private railroad should be established; it will not publish rates and will not be authorized to move goods on behalf of any other shipper tendering traffic to the railroad. In fact, a private railroad is prohibited from accepting

[1] Circus unloading is the process of driving a trailer off its flatcar to the next car continuing from car to car until a ramp leading from the ground is reached. All TOFC cars are properly equipped for circus unloading.

such shipments. This kind of a short line is the probable solution when one or a few shippers are sufficiently concerned with the future of rail service to acquire properties and operate over them to the junction with a Class I carrier.

The success of a short line operation is fundamentally dependent upon its relationship with its connecting Class I carrier. Even before commencing operations, the short line must negotiate divisions or charges with the connecting railroad(s). Division arrangements are critical to the success of the operation because they are the percentage of the total revenue of the haul which the short line will receive. Therefore, favorable divisional agreements can be the difference between business success and failure. For this reason, it is recommended that a division agreement be established along with the other arrangements before even contemplating a short line operation.

The dependence of a short line upon the connecting railroad is particularly important in the areas of quality and frequency of service. Should connecting service deteriorate, a short line will have little recourse but to suffer a concomitant downgrading in the service it provides unless operating agreements with connecting carriers are prudently negotiated. The short line should seek to capitalize on situations where several carriers interchange. Service agreements, car supply and divisions can be favorably negotiated, when several connecting carriers are vying for the short line's traffic. In the event that service deficiencies actually occur, the short line may bring the service problem to the attention of the ICC.

E.1. Operations

Short line railroad operations are broken down into four categories: transportation, equipment, maintenance, and administration.

The transportation function concerns the actual operation of the rail line itself, the movement of motive power and cars from the interchange point(s) to on-line shippers. Short lines will have at least one interchange with a connecting carrier, typically a Class I carrier, which will provide car delivery and pick-up services. Negotiations for interchange point(s) may often result in the short line having to operate over properties of other carriers for short stretches or crossing lines controlled by other carriers. In these situations, the rules and regulations of the carriers must be followed.

The second category is equipment, primarily the rolling stock required for the operation of the short line. The locomotive is probably the most expensive single piece of equipment. Most are diesel operated and range in horsepower and wheel arrangement according to the use to be made of the unit. A short line may need only consider a basic switching engine which might be a Whiting Trackmobile, a device operable both on the highway and on rail with a limited capacity of from one to three cars. In cases of high density traffic or unusual grade and terrain conditions, larger locomotives of sufficient tractive effort and horsepower may be necessary.

There is fairly active market in used locomotives. A used switching engine may be purchased for $25,000 to $75,000 depending upon the amount of rebuilding that has been performed. However, increased demand for these units due to the creation of short line operations could substantially increase prices of both new and used units. Railroads which operate equipment of this type usually incur $100 to $125 in total operating costs of a locomotive per day, including fuel. Without more specific information on the nature of the railroad, length of haul, number of cars, etc. it is virtually impossible to come up with an accurate estimate of locomotive costs.

The next equipment consideration is railroad cars. It is not essential for the line to own cars but there may be advantages in car fleet ownership. If the short line does maintain its own fleet of cars, its on-line shippers will have a more dependable supply of cars, enabling the line to meet service demands more quickly. Such service will help to insure user satisfaction and continued business. The types of cars composing the fleet would of course depend upon shipper needs. Generally, it will not be economical for the short line to supply highly specialized cars as their use may be limited.

Railroads frequently interchange cars freely in lieu of car rental payments which are commonly known as per diem charges. These charges are based on the age and original value of the car and are assessed either on a per day or time-mileage basis. Consequently, a short-line which can load and move its own cars efficiently, can often benefit from per diem charges, particularly when a short line has obtained a quantity of used cars at an attractive price. However, a disadvantage could be the costs resulting from necessary car maintenance.

There are a great number of special cars used for various maintenance functions. These cars are expensive to acquire and maintain and therefore beyond the scope of most short lines. Such equipment includes wreck cranes, Jordan spreaders, tie machines and "Hi-Rail" vehicles. This equipment may possibly be rented from connecting carriers.

A short line may own no equipment and, therefore, have no road crews of its own. It may, by contractual agreement, have its property switched or operated by the connecting carrier. The decision to operate in such a fashion will depend on the financial and traffic characteristics of the short line.

Maintenance is divided into two subcategories: maintenance of way and structures and maintenance of equipment. Maintenance of way involves the functions necessary to keep the track in adequate condition for service requirements and to meet Federal track standards. Functions include track alignment, tie replacement, rail and frog replacement, ditching, ballasting, ballast cleaning and tamping. Manpower requirements will depend upon the condition of the existing track and length of the line. Sophisticated automatic equipment is probably not necessary for a short line and need not be considered. It may be most practical to enter into a contractual agreement with a connecting carrier or local railroad construction firm to perform track maintenance. This might be the least costly approach where the required work is not sufficient to warrant equipment and track crews.

Structural maintenance includes work necessary to keep appurtenant structures and works including bridges, drainage culverts, embankments, tunnels and buildings, in good repair. As with track maintenance, circumstances may dictate that these functions be handled by contract to another carrier or private contractor.

Car and locomotive maintenance require specialize skills.

Locomotive Maintenance.—There are many mechanical devices in the typical diesel unit and these will require servicing at various times. The major components requiring attention include, wheels and trucks, traction motors, generators, engine block and auxiliary devices, air compressor, and cooling systems. The short line should have certain periodic maintenance performed as preventive measures. Maintenance activities may be performed by a major carrier, probably a connecting one at their shop facilities. The same carrier might also provide standby equipment in the event of equipment failures. It is probably best for most short lines to pursue off-line repairing services rather than to invest heavily in shop machinery.

Locomotives use diesel fuel which can be stored in a stand-tank at track side or delivered and pumped by a local fuel oil dealer. Diesel lubricating oil is also required for the operation. Sand may be an important requirement, especially where heavy loads and grades are involved. The sand is of a special grade and must be stored in a dry area.

Car Maintenance.—Most freight cars require some running repairs although they do not generally require the constant attention required of motive power. Major components to be considered include the car body structure itself, and its doors, grab irons, ladders, painting and stenciling. The elements requiring the most attention are usually located below the car body. These include the couplers, brake rigging and the trucks. The trucks consist of wheels, axles, truck frames and springs and the actual braking components. If the line is receiving special equipment such as mechanically refrigerated cars, the capability to check whether refrigeration equipment is functioning properly may be desirable. Therefore, if the short line wishes to maintain some repair capability a covered work area would be desirable in addition to a block and tackle and some basic welding equipment. If the short line owns its own cars, and one of these cars breaks down while on another road ("bad ordered") it will be returned to the home line for repair. Again, these maintenance duties could be performed by con-

tractual arrangement with the connecting carrier or private contractor.

The last category is administration. This may be divided into financial management, clerical, and marketing activities.

The financial activities include billing, collecting and paying accounts with customers and carriers. Interline settlements may include the collection and payment of rate divisions. Per diem charges are paid by the user railroad to the owner of the car. Another charge, demurrage, is a rental assessed against a shipper or receiver for detaining a car longer than 24 hours for loading or unloading purposes. Other charges such as switching charges, route divisions and interline settlements require clerical work and bookkeeping entries. Payroll functions contain one noteable difference—railroad employees are covered by the Railroad Retirement Act instead of the Social Security Act. Many of the bookkeeping and billing functions may be performed by the connecting carrier for a fee. Such arrangements are recommended when the short line is not in a position to perform these functions efficiently.

Whether marketing efforts are actively pursued depends upon the size of the line, management attitudes and development opportunities in areas adjacent to the line. When the line is jointly owned or operated for the benefit of a few shippers and there are no development prospects, marketing efforts are probably unwarranted. If there are potential shippers on the line or development sites are available for plant locations, consideration should be given to marketing activities. Contact should be maintained with shippers to provide information on the railroad's services and to receive valuable feedback. Contact should be initiated with additional on-line industries that can potentially generate rail traffic. Information with regard to short line operations is available by contacting the American Short Line Railroad Association, 2000 Massachusetts Avenue, NW., Washington, D.C. 20036.

F. Regulations

There are a variety of Federal, State and local regulations with which all parties interested in continuing rail service should be familiar. This section discusses regulatory constraints, especially as they might apply to short line railroad operations.

F.1. Federal Regulation

All railroads engaged in interstate commerce are subject to the Interstate Commerce Act 49 US Code 1 ("ICA"). A Certificate of Public Convenience and Necessity as required by Section 1(18) of the ICA must be obtained prior to the commencement of rail operation. The regulations which relate to Section 1(18) are found in the Code of Federal Regulations (CFR) Title 49 Sections 1120.1 to 1120.8, inclusive. These regulations give the details necessary to file an application with the ICC to construct, extend, acquire, or operate railroad lines. Section 20(a) of the ICA outlines the ICC's jurisdiction to regulate the issuance of transportation company securities. For further information one should contact the Finance Section, Interstate Commerce Commission, Washington, D.C. 20423, or the Office.

ICC regulations provide for maximum hours of services of train and engine personnel, quarterly and annual reports to the ICC, monthly locomotive inspections, car service orders and the realignment of debt and equity structure. There are two important exceptions to ICC regulations which are applicable to short line operations. First, if a short line employs fewer than 15 train and engine service employees, it may apply to extend hours of service (per day) of their workers from 12 to 14 or 16 hours. This exception should promote operating flexibility. Second, accounting and reporting requirements for short lines (with regard to operating statistics, traffic data, balance sheets, income and expense information) are not as extensive as required of Class I railroads.

Full service and switching carriers are subject to FRA track and safety standards. Track and operating equipment found to be sub-standard by FRA can be ordered out of service which could severely effect operations of the short line. Concommittantly, enforcement of FRA standards could result in severe start-up problems and costs on those lines not transferred to ConRail or other railroads pursuant to the Plan.

All railroads will be subject to Operating Safety and Health Act ("OSHA") work safety rules, and local or State emission standards. OSHA general industry rules can be found in Vol. 39, No. 125 of the Federal Register (June 27, 1974). There are no Environmental Protection Agency ("EPA") emission standards for railroad locomotives. In order to ascertain local or State standards, contact the appropriate Bureau of Air Quality, or the Air Pollution Control Association, 4400 Fifth Avenue, Pittsburgh, Pa., 15213. New carriers should investigate whether any local or State grandfather classes will be vested in the new owners. Additionally, during fuel shortages, the Federal Energy Administration allocates railroad fuel on the basis of the previous year's usage. Therefore, accurate records of fuel usage should be kept.

Any regulations applying to transportation in particular or business in general may apply to short lines. New operators should become familiar with Internal Revenue Service regulations, the Railway Labor Act and the Railroad Retirement Act.

F.2. State and Local Regulation

These regulations may relate to the operation of a transportation business, but more importantly there are laws which govern the establishment and operation of a business entity, such as a corporation or partnership. For example, if the short line company is to be a corporation then State corporate law must be followed. The business entity must be established prior to applying for ICC authority.

State public utility commissions have varying authority over rail lines, primarily in the area of safety. To what extent this function will be displaced by OSHA and the FRA, if any, is not yet determinable.

There are also local and county laws which may govern the establishment of businesses. Legal counsel should be retained to ensure that all laws and regulations are being accurately followed.

G. Business Structure

One of the first steps in establishing a short line or any other business structure, is the selection of the form of ownership. Forms of ownership are governed primarily by the laws of the state of incorporation. Forms of ownership include the corporation and its variations, cooperatives, partnerships, joint ventures, proprietorships and government ownership.

Probably the most logical and preferred form of ownership is the corporation, as it provides several very important benefits. Foremost among these benefits is the concept of limited liability. Owners of the line are insulated from personal liability in the event of suit. Regulatory treatment of proprietorships and partnerships is noticeably more cumbersome which may be considered to be an additional benefit of the corporate form. Furthermore, the corporation has an infinite whereas partnerships and proprietorships are limited to the lifetimes of the owners. Governments may be reluctant to grant easements or seek easements from railroads whose "lives" will expire with the owners. Another attractive feature of a corporation is its convenient methods for distributing ownership—capital stock—plus other financing instruments such as bonds and debentures.

A cooperative association can be an appealing form of ownership when there is a small group of very concerned users of rail service. For example, when perhaps a dozen shippers are sufficiently concerned with future rail service that they are willing to acquire the right of way, then some sort of nonprofit association could be formed to acquire the line and lease it to a short line operator. Cooperatives may also be attractive when it is anticipated that the short line operation will lose money. In such situations, a funding technique must be developed which provides needed cash to the short line while allowing the contributors to treat the contribution as a tax deductible expense. In contrast, the corporation may be a less desirable form of ownership for tax purposes since such contributions will be treated as investments.

It should be noted, however, that under the Internal Revenue Code, some short line corporate structures might be eligible for treatment as a Subchapter "S" corporation. Under Subchapter "S", eligible, closely-held corporations are taxed as partnerships. Thus, the losses of the short line railroad can be passed through to investors for tax purposes. Before any decision is reached as to the tax advantage of alternative structures,

tax questions should be researched carefully.

The potential operating viability of the short line will have a fundamental influence on its ownership structure and operating nature. The railroad probably will be operated as a full service common carrier when the motivation is to provide socially desirable rail service. If it is anticipated that the line will be profitable, operation as a full service common carrier is even more desirable in order to maximize total traffic.

Full service common carriers or switching carriers can be operated by a private enterprise or by a public institution. If ownership and operation of the line are to be separate, often a public or quasi-public authority will own the right of way and infrastructure while leasing these facilities to a private profit-oriented company which will operate the line. Some situations will require public ownership because private investors will apprehensively view the large initial investment necessary for purchasing rail properties.

When short line operations are established to meet a public need and deficits are unavoidable, then a public authority is logical. Thus, separate ownership and operation of the line is probably a moot issue because the public owner will also have to operate the line.

H. Acquisition

Control of the light density line requires several key decisions, including questions of public versus private ownership, purchase versus lease of properties and joint versus separate ownership and operation. These decisions, as they relate to acquisition of properties, will be influenced by the financing, corporate structure and the potential viability of the operating entity.

Acquisition of rail properties is best achieved through a negotiated sale agreement. An arm's length agreement between buyer and seller is preferable because it minimizes the substantial time and resources required to litigate a transfer of properties. In addition, a negotiated sale enables both parties to structure a transaction in a manner which reflects the preferences of each party.

In those cases where the selling railroad and the buyer are unable to reach an agreement, powers of eminent domain may be used. While a condemnation proceeding will typically insure property acquisition, the proceedings are often lengthy and expensive. Under the Act, the Association has the authority to order bankrupt railroads to transfer rail property to a solvent railroad or ConRail. Accordingly, if a community does not wish to acquire rail properties, but is willing to provide incentives which would make an acquisition attractive, it may be able to convince the Association to order a transfer of rail properties.

When determining whether to acquire rail properties, it should be understood that several sellers may be involved. Some of the properties may be owned outright by the railroad and others may be leased to the railroad. It is even conceivable that although a railroad may own a desirable piece of property, the railroad may not have any operating rights to it. For example, terminal and operating facilities, which were not needed as part of a Class I operation, may be necessary as part of a short line operation.

In some instances, a leasing arrangement will be superior to outright acquisition. One arrangement is a sale-leaseback plan whereby a Class I carrier sells the facilities to the community and agrees to lease and operate them. This arrangement serves to maintain rail service by the existing carrier. An important consideration in the sale-leaseback arrangement is for communities and users to make certain that the carrier (lessee-operator) intends to provide an acceptable quality of service. In this regard, a lease arrangement directly with a Class I railroad is preferable to a lease with a subsidiary of that railroad. Moreover, the time period covered by the lease should reflect a decision as to the future of rail service on the particular properties. In this regard, a long-term lease should not be negotiated when it's clear that shippers, in time, will no longer need or want rail service. Conversely, long-term leases are appropriate when there is a clear indication of substantial development on the line.

Another leasing arrangement is for a short line operator—or a government authority—to lease properties from the abandoning railroad. The rental fees can provide a fair rate of return and save the railroad salvage efforts. For the community, it obviates the need to raise the money to purchase the properties.

Properties can also be acquired by negotiating a direct settlement with mortgagees and other senior lienholders. Assumption of an existing mortgage is plausible with certain preconditions. First, the mortgage should be secured by properties sought by the acquirer. Second, the value of the property should be less than the values of the mortgage claim plus other more senior claims, otherwise the estate's trustee holds a valuable interest in the property, which the trustee would not want to relinquish without compensation.

Direct settlements are possible when the mortgage is willing to reduce his claim in exchange for a mortgage assumption by another party. When this is the case, title and secured claims can be transferred. The trustee is benefited because the estate is relieved of the claims which exceed the value of the property. The new mortgagor is benefited because this arrangement provides for acquisition of the desired properties with a minimum expenditure.

One of the most difficult problems of acquisition is the valuation of rail properties. Valuation is a prominent issue of conflict between the Association and the railroads in reorganization. The Association and the bankrupts differ over the principles and appraisals of the properties which will be conveyed to ConRail and other purchasers. One approach is to value property on the basis of its salvage or net liquidation value. The salvage value concept rests on the premise that a bankrupt railroad has no alternative use for the rail properties other than to liquidate them. To appraise the properties, the salvage market value of the land and other removable properties would be calculated; the expenses required to remove and dismantle these properties would be subtracted from this value.

A second theory of valuation is that property should be valued on the basis of its ability to generate income for rail purposes. Another way is to value property on the basis of its net book value as carried by the railroad.

Once the buyer and seller agree on a valuation principle that is acceptable to both parties, an agreement must also be reached on the application of the principle—the appraisal. The appraisal is fundamentally influenced by the methodology used to calculate the values. For example, the methodology will provide estimates of the time required to remove the materials from the property and the expenses needed to restore the facilities to an acceptable condition. Furthermore, the methodology includes a realistic period of time required to carry out the liquidation program. Accordingly, the buyer and seller must also agree on timing, scrap prices, land values, and dismantling costs.

Where right-of-way ownership is restricted by a reversionary right, the railroad has little bargaining power to demand compensation for the land comprising the right of way. If a reversionary right applies, then when a line is abandoned, the land reverts back to the previous owner. Thus, concerned public bodies should determine whether reversionary rights exist on any of the properties proposed for abandonment.

A problem which is becoming increasingly prevalent is how to transfer the property designated for conveyance in the Plan. Section 303(b)(2) of the Act requires that all property be conveyed free and clear of all liens and encumbrances. This mandate has far reaching ramifications since railroad property for the most part is heavily encumbered as a result of the elaborate financing schemes used by railroads in the past. In addition, almost all properties are encumbered with local tax liens. Thus, purchase of properties directly from the bankrupt estates requires that the transaction include a solution to the problem of liens.

The city, county and State legal departments should be contacted to determine the extent of encumberances existing against specific rail properties. Once these encumberances are identified it will probably be necessary to co-operate with government entities at the local, county and State levels to decide on a strategy for resolving the claims. As an example, a State may compile listings of rail lines within that State which are encumbered by reversionary clauses or tax liens and scheduled to be abandoned. The trustees of the railroads involved could then be approached to negotiate a solution with the option of the State becoming the owner of these lines. The

State could then either operate the lines or lease them to operating companies, thereby preserving rail service.

I. Sources of Funds: Developing a Financial Plan

The financing approach to continuing rail service should be coordinated with whatever operating approach is selected by the community and rail users. However, sufficient latitude exists to permit innovative financial solutions. Communities and rail users have many opportunities to minimize their financial involvement by utilizing various investment techniques. This section will discuss private financing, public financing and non-cash inducements for continued rail service.

I.1. Private Financing

Many programs of continued rail service will rely, at least in part, upon private sources of funds. Private financing may be available because of specific private interests or because of incentives in the private capital markets. A program which establishes a business enterprise will require financing of working capital, fixed infrastructure and an ownership interest. For example, a short line railroad may need to establish a line of credit with a commercial bank in order to secure working capital for its day-to-day operations. The right of way and fixed plant may be financed by bonds or mortgages. Equity capital can be sold to distribute ownership shares.

Local and State government entities may undertake programs to attract private funds with inducements such as:

Leases, tax shelters, guaranteed financing, indirect subsidies, associations of users.

A financing technique which almost certainly can improve the financial plan for most short line railroads is leasing. Locomotives, rolling stock and other equipment are properties which private investors will lease to a railroad. This type of asset is attractive for leasing because the lessor can readily repossess and resell the property if the lessee violates the lease. The lessee (operating railroad) benefits from leasing because it is not necessary to raise capital to purchase the asset. The lessor may be able to offer an attractive rental price depending on tax benefits which may be available.

Another type of incentive is where the Government guarantees the payment of interest, principal, and/or dividends on an obligation. Such guarantees greatly reduce investor risk, thereby providing substantial inducement to private investors to supply funds. Guarantees are particularly useful when a government entity does not wish to be directly involved in financing the continuation of rail service but is willing to bear some of the risks.

Similarly, inducements may be provided by interest rate subsidies. For example, the non-taxable bond is a form of interest rate subsidy. Allowing interest on a short line's debt to be exempt from income taxation may also aid in attracting funds.

Interest rate subsidies can take other forms. If a concerned group is willing to provide low cost capital for the continuation of rail service, then it may be possible to issue securities at interest rates below normal market levels to "friends of the railroad." An alternative method is that a group of concerned citizens and industries acquire the rail properties and then lease these properties back to the railroad at rentals which are less than the cost of debt service.

The tax shelter is a potential financing technique if the light density line operation establishes a business structure which can pass losses through to investors. Tax shelters often receive unfavorable publicity, but their purpose is to encourage investment in activities which are normally unable to compete in capital markets without special provisions to increase after-tax profits. Attractive depreciation rules can serve as tax shelters. Another technique is the depletion allowance, which would allow railroads to expense depreciation on the basis of traffic or revenue and would serve as an offset to revenue to minimize income tax liability.

I.2 State and Local Financing

Eight forms of public financing for retaining rail service can be considered:

(1) General obligation bonds;
(2) Revenue bonds;
(3) General tax revenues;
(4) Development districts or zone;
(5) Special tax assessments or surcharges;
(6) Regional authorities;
(7) Development corporations;
(8) Grants.

General obligation bonds are debt instruments used to supply the debt capital requirements of many State, local and county governments. They are supported by the full faith and credit of the government institution. Revenue bonds are used to finance public works projects such as airports, bridges, and sewer systems. The fees derived from operating these projects are used to service the bonds. Revenue bonds are typically issued at interest rates somewhat higher than general obligation bonds, because they are often not restricted by many of the statutory requirements covering general obligation bonds. Moreover, since revenue bonds are secured by a revenue producing operation, it is easier for governing bodies to authorize their issuance.

Analogous to general obligation bonds, general tax revenues are a source of financing of rail projects unless there are prohibitions against using tax monies for such purposes. Financing by general obligation bonds and general tax revenues distribute the investment burden over the total tax base. However, financing through revenue bonds distributes the burden to users of the project.

In some situations the financial burdens of continuing rail service can be more directly placed on those benefiting from the continuation through the establishment of development districts or zones. An example of a development district is a downtown area of a city where merchants agree to pay a special tax to finance the debt service required for the construction of a downtown municipal parking garage. In order to finance the continuation of rail service, a local government could establish tax districts along the areas served by the rail line. The rationale is that the values of land adjacent to a railroad is enhanced because of the improved opportunities for development due to the availability of rail service. Zones could be designated wherein all land owners in the proximity of the right of way would be assessed a special tax or surcharge depending on their location.

The concept of a special tax zone is directly analogous to the idea that special tax assessments should be used to distribute the burden of the program to those who are the beneficiaries. Therefore, in addition to specific geographic districts, special taxes should be considered. For example, the government could institute a special tax upon industries which are the direct beneficiaries of continued rail services. Alternatively, sales taxes may be used if the project has identifiable benefits for the entire local or regional economy.

Sometimes the difficulty in raising public funds is the political impediment of gaining authorization for additional taxes or bond issues. When this barrier exists, it is useful to seek out alternative public institutions—such as a regional authority—which can extend its activities into the ownership and operation of railroads. For example, several years ago the Port Authority of New York and New Jersey stepped in and acquired the Hudson Tubes for the purpose of providing vital public passenger rail services when the common carrier could no longer serve the market. Similarly, regional authorities could acquire and operate lines of the bankrupts to provide services to existing shippers and to facilitate industrial development.

If no such institution exists or it is considered too elaborate to establish, then "development corporations" might be a convenient alternative. Some localities and regions have already established development corporations which function to acquire land and then to promote and finance commercial and industrial development. The success of development corporations is largely dependent on the assistance they can provide to industrial tenants in their efforts to raise capital. Many industrial development corporations purchase land and erect industrial parks financed with tax exempt bonds. The space is then leased to a business at rentals which reflect the low service costs on the tax exempt bonds. A development corporation is ideally suited for the financing of continued rail service because it can raise capital at relatively low interest rates and can issue bonds without the impediments of municipal financing.

I.3. FEDERAL FINANCING

In addition to private funding at the State and local levels, federal funds are available to help finance the continuation of rail service.

Title IV of the Act provides $180 million of Federal funds designed primarily to continue rail service on light density lines not recommended for service in the Final System Plan. These sums must be matched to a minimum of 30% by other parties.

The Act envisions that operating subsidies will not be the only method utilized to continue the operation of rail lines which are not included in ConRail. Sections 402 and 403 of the Act provide that Federal dollars be made available on a matching basis to local, regional and State transportation authorities for acquisition and modernization of rail lines.

Section 402 provides that the $90 million discretionary fund, over which the Secretary of Transportation has control, may be used for Section 403 purposes, i.e., these funds can be allocated for acquisition and modernization of rail lines. Any grants made under the discretionary funding portion of Section 402(b)(2) for modernization and acquisition must be pursuant to the State Rail Plan required under Section 402(c). The local, regional, or State authority must match the federal funds with at least 30 percent.

Section 403 provides for acquisition and modernization loans to local, regional and State transportation authorities of states eligible for subsidy funds under 402(c). The funds for Section 403 are provided for in Section 211 of the Act. The amount of money which will be available for this program has not yet been determined. The Federal share must be matched by the recipient of Federal funds on at least a 70–30 basis. (Any project for which a Section 403 loan is made can no longer receive a rail service continuation subsidy under Section 402).

It should also be noted that there are numerous sources of funds available under Federal grant programs that may be used for any of the alternatives to subsidization. Many agencies, such as the Department of Commerce, the Department of Housing and Urban Development, and the Department of Transportation, offer assistance in the form of project and research grants, direct loans, and guaranteed/insured loans to public and private organizations and private citizens. Both profit and non-profit institutions are eligible.

I.4. THE USE OF TAX CLAIMS

Railroads pya txes to State and local governments. The taxes paid are mostly on real estate, but other types of taxes such as ad valorum taxes, State franchise taxes, unemployment tax, and school taxes, may also be paid by the railroads. Unpaid State and local taxes are one of the largest claims against the estates of the bankrupts. Past and future taxes can function as a source of funds for communities interested in continued rail service.

An intriguing concept for raising funds to be used for preserving rail service is to treat forgiveness of tax claims as a method of financing. In railroad reorganizations, tax claims are senior debts of the estate. Tax claims which accrued after the petition for bankruptcy are considered administrative expenses of the estate and are accorded the high priority which is given to such claims. However, tax claims which result from nonpayment before bankruptcy (pre-petition) are not given as high priority, but they are still relatively senior. Those tax claims which statutorily constitute liens on the property are known as secured tax claims. This class of claim is accorded the highest priority of all pre-bankruptcy claims (save one small class). However, some localities do not place liens upon property when the taxes are in default. For these claims, the priority is lowered to "unsecured" tax claims. Nevertheless, most localities have a substantial claim against bankrupt estates because of post-petition deferrals. It is these senior claims which can be used as an attractive source of capital.

Forgiveness of tax claims is, strictly speaking, an inappropriate term for describing the use of tax claims as a source of funds. Forgiveness implies the relinquishment of claim without a corresponding exchange of consideration from the debtor. In contrast, the theme of this discussion is that consideration will be received in exchange for relinquishment of a claim; thus, forgiveness is essentially part of a contractual agreement between the debtor and the claimant.

For what purposes can such tax forgiveness be used? These claims will probably be useful for acquisitions and/or inducements for other financing arrangements. An obvious use for tax claims is as the consideration in an acquisition of rail properties. For example, assume there are tax claims against a bankrupt carrier held by county and local governments. If the agreed purchase price of the line were $50,000 and the tax claims were $10,000, then this amount could be applied towards the purchase price. The governments would have to raise $40,000 additional dollars to acquire the rail line. An important issue which must be considered is possible sources for the needed $40,000. To carry the example further, assume the county has properties of the bankrupt carrier within its jurisdiction; undoubtedly, tax liens and claims exist against these properties as well. Therefore, can the claims against the non-acquired properties be used to offset the purchase of the desired rail line? Can the State allow some of its own claims against the estate to be allocated for the purpose of satisfying the purchase price of the rail line? These issues are not altogether clear in every case; however, as long as the State and local governments hold senior claims against the estates, the trustee(s) should be willing to listen to reasonable offers aiding the settlement of the estate. Thus, if the tax claim offset against the purchase price appears to be an attractive way to dispose of claims, then the trustee will likely be amendable to offers from the government agencies.

Forgiveness of tax claims may also emerge as a useful technique in financing inducements for continued rail services. A typical inducement will be the standardized rail service continuation subsidy under the Act. Since the subsidy provider is responsible for providing a rate of return on investments to the estate of the owner of the line under subsidy, then tax claims forgiveness might offset this expense in total or in part.

Somewhat more complex is an arrangement whereby the operating carrier which does not own the infrastructure contracts with the subsidizer to provide continued rail services. This sort of arrangement might be possible if a solvent carrier acquires portions of an estate which is conveying substantially all of its assets. In this case, the acquirer could satisfy its purchase obligation by assuming a State/local tax claim which in turn would be forgiven in exchange for an operating subsidy. A hypothetical application of this rather complex arrangement would be an agreement in which the Chessie operated an undesignated light density line of the Reading Company. The agreement for operations would be between Chessie System and the subsidizer. However, if the Chessie purchases portions of the Reading Company, part of its purchase price could be "forgiven" in exchange for operating contracts over the undesignated line. It would be contracturally agreed that the Chessie arrangement would be "consideration" conveyed to the Reading Company for some properties. This consideration would be directly applicable to satisfy Reading's claims to the governments involved in the subsidy contract. Thus, a three-way arrangement is formed from the subsidizer to the Chessie in which the subsidizer's liens against the Reading Company are used as partial payment to the Chessie.

In contrast, the Boston and Maine is a special case because it is a railroad which has substantial liens against it, and it intends to remain in business. These tax liens could be contracturally eliminated in a court-approved operating agreement in which the claim is forgiven in exchange for some sort of operating agreement. (An operating agreement between a subsidizer and the Boston and Maine is not restricted by the Act).

There are several issues which will have to be recognized and resolved before the forgiveness of tax claims becomes a functional alternative method of retaining rail service. Usage of tax liens for such purposes is unprecedented and has no statutory guides. Pitfalls exist within the estates of the bankrupts, as well as within the political structure and laws which constrict the subsidizer.

The subsidizer should be prepared to negotiate and compromise with the trustee of the bankrupt estates. However, these negotiations will not be easy because the trustees may not necessarily interpret themselves as having the authority to make the agreements envisioned by the subsidizer. In fact, some trustees do not have the staff needed to react to matters as complex as offset-

ting liens against subsidy costs. The most important factor to bear in mind is that most railroad reorganization plans are the result of compromised negotiated agreements among classes of claimants in which full compensation is not received, but the settlement is superior to continued litigation. The State and local claimants, despite the seniority of their claims, are in the same predicament. It will take many years to distribute the proceeds of the reorganization plan. Therefore, if a State and local government is interested in utilizing its claims in the near future, it must be prepared to offer an attractive deal to the trustees which the trustees can submit to the reorganization court for approval. If the proposal is clearly unfavorable, the trustee or some other class of creditor will undoubtedly successfully block the contract.

As can be seen, one of the extremely important issues is the different classes into which the state and local governments' claims can be allocated.

Tax claims are separated according to the following categories:

(1) Secured—unsecured;
(2) Interest;
(3) Pre-petition—post-petition;
(4) Federal tax claims.

A secured tax claim is that in which local statute provides the tax claimant with a lien on the property to which the taxes are in default. An unsecured tax claim is not secured by such a lien. The bankruptcy statutes treat the secured claim with a higher priority than unsecured claims. If the proceeds from the disposition of a particular property do not fully satisfy the claims of the tax lienholder (claimant), then the claimant may have an unsecured claim against the remainder of the estate. The courts treat interest on such claims in a wholly subjective manner. Very often they will not accept interest on post-petition tax accruals. However, some courts have given some weight to interest on pre-petition tax claims. At this stage, it is impossible to conjecture what a probable interest rate will be even if the courts decide to recognize interest claims.

Tax claims, like all other claims, are ranked according to the time of incurrance of the claim. Claims which accrue after the petition for bankruptcy are known as post-petition claims. These are related to the cost of administration of the estate in order to keep the estate operating until it is reorganized. These claims are afforded the highest priority. Vendor-type claims which occur just before the petition for bankruptcy receive the next highest priority. Then pre-petition claims are addressed. The most senior class among these is secured tax liens. Unsecured tax liens are subordinate to these and other secured liens. (An example of another lienholder is the mortgagee on properties.) Secured claims are probably of high enough priority to be useful levers in negotiations.

State and local claims are subordinate to Federal claims. However, unresolved at this time is whether unsecured Federal claims are senior to secured state and local claims. Another issue facing the State and local creditors are the residual claims that they hold beyond their lien. That is, can the State/local claimant holding a lien against a particular property bring an unsecured claim against the entire estate if the proceeds from the sale of the secured property are not sufficient to satisfy the lien?

Even though the State/local claims are rather senior claims, in many cases they will not be satisfied in cash at 100 cents on the dollar. In fact, some sort of paper is likely to be issued and the market value may be at somewhat of a discount to the recognized claim. Furthermore, it is very possible that disposition of a claim could take many years from the time of conveyance to ConRail. Thus, the proceeds to be distributed to the State and local governments are likely to have a present worth at a very substantial discount of their base claim. Once again, there is cogent reason for the state and locals to negotiate an agreement with the estate.

An interesting wrinkle which will emerge in some of these negotiations is the inset of reversionay rights. When many of the railroads were built in the region, the State provided the railroad franchise with the right to construct the railroad with the provision that if the railroad ceased to exist, then the land would revert back to the original owner or the State. Thus, if the railroad abandons a line, it does not actually hold the salvage right to the land, but merely the removeable structures. In such cases, it may be more advantageous for the State/local governments to permit the railroad to abandon the line; then, the government can take over the right of way when the reversionary rights become effective. In effect, a costless acquisition of the land has occurred. Of course, statutory constraints at the State and local level will have to be researched before properties can be taken over by this method.

J. Non-Cash Financial Incentives

Tax credits are a way to enhance the prospects of a project; they can be used as incentives to users or suppliers of rail service. A special investment tax credit could be applicable to investors in light density line projects. For example, rehabilitation expenditures could be accorded a specialized accounting treatment by State and local taxing authorities. In States with income taxes, rehabilitation expenditures could be treated in a manner similar to the Federal investment tax credit. Where income taxes do not exist, then special provisions for rehabilitation could be used to offset assessed real estate tax rates.

Communities may not need to provide direct economic impetus to attract investor support for a light density line project. Often the powers of the community government can be brought to bear to make the operations of the light density line more attractive. Typically the community controls zoning, development and public works. Each of these authorities could provide incentives with very real implications to the owners and operators of rail lines.

Class I railroads and potential investors in a short line enterprise will often consider the overall package much more attractive if it is accompanied by the prospect for development of railroad owned land adjacent to the line. Changes in zoning classifications on these lands could facilitate railroad-lead development. An agreement could be made wherein the railroad would agree to upgrade its rail facilities in exchange for certain land and/or zoning changes. Another incentive is to use the capability of the community's office of public works. The community could assume the responsibility for maintenance of some structures on the right of way in exchange for continued or improved rail service on the line.

In summary, local, county, regional, and State governments have potentially numerous ways of enhancing the prospect for continued rail service on a line without simply establishing massive subsidy and acquisition programs. However, the applicability of these techniques has to be considered with regard to each individual light density rail line.

[SEAL] Robert L. Oswald,
Secretary.

Appendix A—Relevant Factors in the Benefit-Cost Analysis

In determining whether a particular rail property is suitable for a service continuation subsidy, the potential subsidizer should focus on the economic, social, and environmental factors involved in the loss of rail service, and possible shift to alternative modes, assessing them in quantitative and/or qualitative terms.

The major economic factors which should be considered in assessing the impact of rail discontinuance are: (a) Employment. Layoff or transfer of railroad employees; curtailment, relocation or cessation of operations by rail users; reduction in work force by firms providing goods and services to the affected area; and additional jobs created in the affected area. (b) Income. Loss or gain of compensation, to all employees identified in (a) above, in the form of wages, salaries, dividends and fringe benefits; proprietors' income generated by small business firms providing retail and wholesale goods and services, including farms; rental income resulting from rental of property and equipment by individuals; and corporate profits produced by generally large manufacturers. (c) Financial Aid. Increase or decrease in employment benefits paid to laid-off employees; welfare benefits paid to affected employees and their dependents; relocation allowances made to employees wishing to relocate in their jobs; retraining expenses to retrain employees who lose their jobs; and government aids to private industry in the form of special grants, waivers, etc. to adversely affected business firms. (d) Taxes. Loss or gain of revenue accruing to local, State and Federal governments generated from personal income taxes; sales taxes; property taxes; and corporate taxes. (e) Modal Costs. Increased or decreased operating costs, including fuel consumption, incurred by businesses in the use of an alternative transportation mode, with due consideration of such elements as packaging, loading, transloading, switching and linehaul costs. (f) Consumer Costs. Increased or decreased costs of goods and services to

consumer brought about by changes in costs (i.e. transport costs) incurred by affected manufacturers, wholesalers and retailers. (g) Other. Loss of future benefits due to decreased potential for new industrial development and plant expansion where rail service is essential; unavailable or impractical alternative transportation modes because of local road and bridge conditions or because of the nature of the product being shipped, such as coal, fertilizer, grain or lumber; and lowering of commercial and residential property values dependent upon rail service, affecting the worth of those who own such properties.

The major social factors which should be considered are: (a) Demographic Changes affecting population; urban/rural composition; housing patterns; and life style peculiarities. (b) Economic. Effects on the diversity of economic base of the affected area; and the diversity of skills among the affected area's labor force. (c) Taxpayer Costs. Budgetary uncertainties and changes in funding priorities, irretrievable commitments of funds for projects and public services no longer needed; disruption of land use plans and zoning regulations, including possible re-use of rail rights-of-way for agricultural, commercial, industrial or residential purposes, transportation-related purposes or recreational, tourist, wildlife, hobby, or historic preservation purposes; and overall government economic, social, energy and epvironmental objectives, policies and programs.

The major environmental factors which should be considered are: (a) Air Pollution. Pollutants (i.e. carbon monoxide, hydrocarbons, and nitrogen oxides) produced by combustion in diesel locomotives; and pollutants produced by alternative transportation modes, especially trucks. (b) Land Pollution. Esthetic conditions, such as accumulation of litter and weeds along rail lines; traffic congestion on highways and streets resulting from a switch to an alternative transportation mode, such as trucking; and public safety hazards, such as brush fires produced by locomotive sparks, motor-vehicle accidents at railroad grade-crossings and motor-vehicle accidents on highways and streets if the alternative transportation mode is trucking. (c) Noise Pollution. Noise levels, for both the railroad and the alternative transportation mode (usually trucks), depending on such factors as locations of the rail line and major highways and streets in relation to locations of schools, hospitals and residential neighborhoods; types of equipment used by the railroad and the alternative mode; the number of railroad grade-crossings and State Laws concerning audible warnings; number and age of motor vehicles required to replace rail; types of motor vehicle engines to be used—diesel vs. gasoline; and overall level of background noise. (d) Water Pollution. Interference with normal water flow by railroad causeways; the threat to water quality by the application of pesticides to railroad rights-of-way for weed and brush control; and fuel spillage, especially at railroad fueling stations, shops and terminals.

INFORMATION SOURCES APPENDIX B

The following, which are referred to in the preceding text, are suggested as useful sources of information to those who are interested in the rail service continuance subsidy program provided for under the Regional Rail Reorganization Act of 1973. They are listed in chronological order according to their date of issuance. A limited number of copies of these sources are available from the Rail Services Planning Office, Government and Industry Liaison, 1900 L Street NW., 5th Floor, Washington, D.C. 20036, (202)/254-3294).

*Regional Rail Reorganization Act of 1973, Public Law 93-236, 87 Stat. 985 (January 2, 1974).

*Rail Service in the Midwest and Northeast Region, A Report by the Secretary of Transportation, Volumes I and II, 39 FR 5392 (February 1, 1974).

*Evaluation of the Secretary of Transportation's Rail Services Report. A Report of the Rail Services Planning Office, 39 FR 17147, (May 2, 1974).

*Rail Service Continuation Subsidies, Standards for Determination, Rail Services Planning Office, 39 HR 24294, (July 1, 1974), with Amendments, 40 FR 1624, (January 8, 1975), and with additional Amendments, 40 FR 14186, (March 28, 1975).

*United States Railway Association Annual Report June 30, 1974 with a Supplemental Report Through October, 1974. (November 13, 1974).

*Preliminary Views on Rail Restructuring, Comments of the Rail Services Planning Office (January 10, 1975).

*Guide for Evaluating the Community Impact of Rail Service Discontinuance, Office of Public Counsel, Rail Services Planning Office (January 10, 1975).

**Continuation of Local Rail Service, Procedures and Requirements Regarding Applications and Disbursement*, Federal Railroad Administration, U.S. Department of Transportation, 40 FR 4232 (January 28, 1975).

**Analysis of Community Impacts Resulting from the Loss of Rail Service*, CONSAD Research Corporation, Prepared for United States Railway Association, Volumes I, II, III and IV (February 14, 1975).

**Preliminary System Plan*, United States Railway Association, Volumes I and II, 40 FR 9323 (March 4, 1975).

**Evaluation of the U.S. Railway Association's Preliminary System Plan*, A Report of the Rail Services Planning Office, 40 FR 21802 (May 19, 1975).

**Community Self-Help Methods to Preserve or Reinstitute Rail Light-Density Line Service*, Ernest Weiss. Prepared for Rail Services Planning Office (June 6, 1975).

[FR Doc.75-29914 Filed 11-6-75;8:45 am]